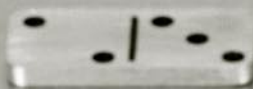


The PERAC Financial Bulletin

Financial Market Review, 1st Quarter 2005

APRIL 2005 | NO. 25

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No. 25 April 2005

Public Employee Retirement Administration Commission

Five Middlesex Avenue
Third Floor
Somerville, MA 02145

Phone 617 666 4446
Fax 617 628 4002
TTY 617 591 8917
Web www.mass.gov/perac

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Q1

Both stocks and bonds turned down during the first quarter of 2005 as concerns over rising interest rates and inflation weighed on the markets. As the price of oil hovered around \$55 a barrel, measures of overall inflation approached 3% for the first time since 1993. It was not surprising that the Federal Reserve continued in its series of tightening moves, but its statement that “pressures on inflation have picked up in recent months and pricing power is more evident” was read with concern by investors.

Stocks were held down by rate worries (rising rates not only make stocks less attractive but tend to dampen economic growth) as well as by the expectation that, with the possible exception of oil companies, growth in corporate profits would be declining from its impressive recent rates. The S&P 500 Index declined 2.15% while, in a reversal of the pattern of the past six years, small caps under-performed large caps as the Russell 2000 Index declined 5.34%. The technology-laden NASDAQ Composite performed worst of all, falling 8.1%. For these three indexes, the quarterly decline was the worst in two years. The Dow Jones Wilshire 5000 Index, a measure of the broad market, declined 2.39%. While large caps appear to be regaining their footing relative to small caps, value stocks continued to outperform growth stocks, at least

according to the Russell Indexes.

As usual, individual stock selection was crucial. Not surprisingly, Exxon Mobil had an excellent quarter, up 16.3%, while General Motors, which issued an alarming downward profit warning, and insurance giant AIG, hit by accusations of irregular accounting practices, were among the worst performers, down 26.6% and 15.6%, respectively.

Overseas markets basically reflected the concerns and trends of the US market, with only energy and commodity-related companies providing strong returns. The fact that the US dollar enjoyed a surprising rally in the currency markets further weighed on returns from international stocks. Specifically, while the MSCI-EAFE Index was up 3.36% for the quarter in local currency terms, it was down 0.17% in dollar terms. Emerging markets in Asia and Latin America benefited from the rise in oil and related prices, but they were hurt by an increasing aversion to riskier assets following the GM disclosure; for the quarter, the MSCI Emerging Markets index was up 1.80%.

The bond market absorbed the latest two of the Fed’s seven quarter-point increases in the Federal funds rate as well as Chairman Greenspan’s remark in February that it was a “conundrum” to him why long-term rates were actually declining in the



Chart 1

S&P 500: After 2004's Late Rally, A Down Quarter

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face of rising short-term rates. The rate on the 10-year Treasury note, which began the quarter at 4.22%, rose as high as 4.69% in late March before closing at 4.49% at quarter end. Corporate bonds in general and high yield bonds (which had been up about 12% in 2004) in particular were impacted by GM's surprising profit warning which led to concerns that the giant automaker's credit rating might soon fall to "junk" status.

After extraordinary returns of 28% and 24% in 2003 and 2004, publicly-traded Real Estate Investment Trusts suffered what many felt was an overdue correction during the first quarter, with total return of -7.05%. When released, returns on the NCREIF national (private) property index were expected to

remain positive, although there were some signs of weakness in some major market segments.

The sharp quarterly decline in the NASDAQ contributed to sluggishness in the market for initial public offerings. Accordingly, it is expected that, when released, quarterly benchmark returns from venture capital and other private equity will be lackluster.

Neither were hedge funds able to provide significant diversification benefits during the quarter. Initial indications were that most strategies were flat to very modestly positive, while one major strategy, convertible arbitrage, suffered modest losses under the pressure of rising interest rates, widening credit spreads, and low stock market volatility.

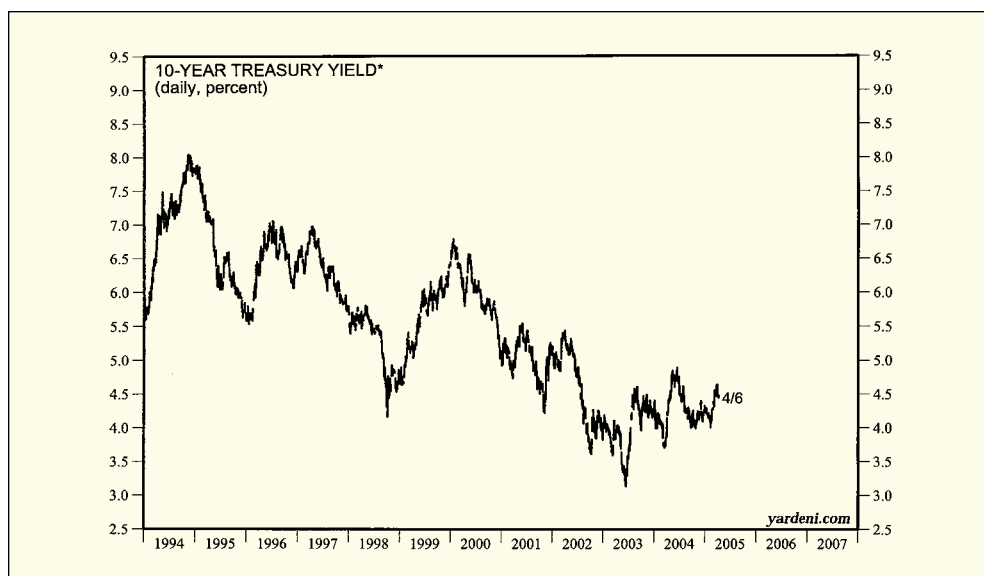
For investors, the first quarter of

2005 was disappointing as it was the first time since the second quarter of 2000 that both stock and bond markets fell appreciably. With recent declines in job growth, interest rates likely headed still higher (although they still remain low by historical standards), and stocks fairly valued at best, the balance of the year could well continue to be challenging. As always, retirement boards should carefully examine their investment structures to ensure that portfolios are as well diversified among asset classes and subclasses as possible and that all managers are satisfactorily fulfilling their mandates.

Chart 2

Interest Rates: Historically Low, But Trending Higher

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TOTAL RETURNS | *1st Quarter, 2005*

INDEX	FIRST QUARTER, 2005	TRAILING TWELVE MONTHS
US EQUITY MARKET		
Dow Jones Industrial Avg.	- 2.06%	+ 3.59%
Standard & Poor's 500 (Large Cap)	- 2.15%	+ 6.69%
NASDAQ Composite	- 8.10%	+ 0.30%
Wilshire 5000 (Broad Market)	- 2.39%	+ 7.14%
Standard & Poor's Mid-Cap 400	- 0.40%	+ 10.43%
Russell 2000 (Small Cap.)	- 5.34%	+ 5.41%
GROWTH VS. VALUE		
S&P 500 Growth	- 1.86%	+ 4.13%
S&P 500 Value	- 2.43%	+ 9.24%
S&P Midcap 400 Growth	- 0.09%	+ 8.93%
S&P Midcap 400 Value	- 0.71%	+ 11.90%
Russell 2000 Growth	- 6.83%	+ 0.87%
Russell 2000 Value	- 3.98%	+ 9.79%
INTERNATIONAL EQUITY		
M.S.C.I. - E.A.F.E.	- 0.17%	+ 15.06%
M.S.C.I. - Emerging Markets	+ 1.80%	+ 16.62%
FIXED INCOME		
Lehman Brothers Aggregate Index	- 0.48%	+ 1.15%
Merrill Lynch High Yield Index	- 1.44%	+ 6.94%
REAL ESTATE		
NAREIT - Equity Real Estate Investment Trusts	- 7.05%	+ 9.18%
NCREIF Property Index	+ 4.66% (Q4)	+ 14.49% (Trailing 12 months)